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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943.

FIDES, A. G.,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioner, Fides, A. G., a Swiss corpration, respectfully prays for a writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit to review a judgment or decree of that court entered August 16, 1943, affirming a decision of the United States Board of Tax Appeals sustaining a deficiency income surtax and penalty aggregating $11,255.33 assessed by respondent against the petitioner for the year 1936.

Summary Statement of Matter Involved.

The matter involved in this case is the judicial construction of Title IA, Section 351, and Section 291 (Pen-

alty) of the Internal Revenue Act of 1936. It is the first case decided upon similar facts by the Board of Tax Appeals, the first reviewed by any United States Circuit Court of Appeals and the first to reach this Court.

Section 351 provides for the levy and payment of a graduated surtax upon the undistributed adjusted net income of every personal holding company. The material subdivisions of Section 351 follow:

> "(a) IMPOSITION OF TAX.—There shall be levied, collected, and paid, for each taxable year (in addition to the taxes imposed by Title I), upon the undistributed adjusted net income of every personal holding company a surtax * * *
>
> "(b) DEFINITIONS.—As used in this title
>
> "(1) The term 'personal holding company' means any corporation * * * if (A) at least eighty per centum of its gross income is * * * derived from royalties, dividends, interest * * *, and (B) at any time during the last half of the taxable year more than fifty per centum in value of its outstanding stock is owned directly or indirectly, by or for not more than five individuals.
>
> "(2) The term 'undistributed net income' means the net income minus the sum of (A) * * * (B) * * * (C) the amount of the dividends paid credit provided in Section 27. * * *.
>
> "(4) The terms used in this section shall have the same meaning as when used in Title I.
>
> "(c) ADMINISTRATIVE PROVISIONS.—All provisions of law (including penalties) applicable in respect of the taxes imposed by Title I* of this Act shall, in so far

* All of the sections of the Act preceding Section 351 are included in Title I. Section 351 is the only section contained in Title IA.

as not inconsistent with this section, be applicable in respect of the tax imposed by this section."

The facts were stipulated before the Board of Tax Appeals (R. 20). Those material to this application are that petitioner is a corporation organized in Switzerland in 1911. At all the times here relevant it was not engaged in trade or business in the United States and had no office or place of business therein (R. 20). In 1936 all of its outstanding stock was owned directly or indirectly by not more than five individuals all of whom were, during 1936, and at all times prior thereto, nonresident aliens not engaged in trade or business within the United States and not having an office or place of business therein (R. 21). About sixteen years ago petitioner acquired certain American securities and since then it has held and owned American securities and received the income therefrom consisting of interest and dividends (R. 20). It filed its Federal Income Tax Returns (Sec. 144, withholding tax) on the basis of cash receipts and disbursements. Its activities in the United States during 1936 and for many years prior thereto consisted only in effecting transactions in securities through a resident broker or custodian and in receiving the income from the securities held (R. 20).* Petitioner's gross income from sources within the United States for the three-year period ending December 31, 1935, was 28.54 per cent of its total gross income for that period from all sources (R. 21). By the provisions of Section 119 (a)(2)(B) of the Revenue Act of 1936 dividends paid by petitioner in 1936 were not considered or treated as income from sources within the

* Section 211 of the Revenue Act of 1936 provides that the phrase "engaged in business within the United States" does not include the effecting of transactions in the United States in stocks, securities or commodities through a resident broker, commission agent or custodian.

United States and were not required to be included in the gross income of the stockholders receiving them even if the latter resided in the United States. Section 119 reads in part as follows:

> "(a) Gross Income from Sources in United States.—The following items of gross income shall be treated as income from sources within the United States: * * * (2) Dividends.—The amount received as dividends—(A) * * * (B) from a foreign corporation unless less than fifty per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends * * * was derived from sources within the United States as determined under the provisions of this section; * * *".

For the calendar year 1936 petitioner paid Federal Income Tax withheld at the source of $2,586.04 and paid in Switzerland a dividend of 100,000 Swiss Francs, then the equivalent of $28,041.25 in American dollars (R. 21) for which payment it received no "dividend paid" credit (R. 30)* On January 3, 1940, it filed under protest a Personal Holding Company Tax Return for 1936 with the Collector of Internal Revenue at Baltimore, Maryland (R. 1).

Under the stipulated facts, the applicable law and the administrative Regulations promulgated for the enforcement of the Act, petitioner's stockholders would, in no event, be taxable on dividends paid by petitioner because, under Section 119 (a)(2)(B) earnings distributed by petitioner

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* Section 27(h) of the Revenue Act of 1936 provides as follows: (h) Nontaxable Distributions.—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part.

in 1936 would not be considered income from sources within the United States and would, therefore, not be taxable to the stockholders. In addition thereto, under Article 102-1 of the administrative Regulations,* it is provided that, even though a foreign corporation derived income from sources within the United States, its stockholders would not be liable to tax if they were all nonresident alien individuals not engaged in trade or business in the United States and not having an office or place of business therein.

In order to apply correct legal principles to the foregoing facts it is necessary to construe the Act according to the intent and purpose of Congress in enacting it. The only purpose of Congress in its enactment was to reach the "incorporated pocketbook" and to compel the corporation to distribute its surplus earnings so that, when distributed, the stockholders would be liable for normal tax and surtax on the dividends they received and the revenue of the government would thus be increased. *Pembroke Securities Corporation* vs. *Commissioner*, 122 Fed. (2d) 252 (2d Circuit); *Morris Investment Corporation* vs. *Commissioner*, 134 Fed. (2d) 774 (3rd Circuit); *Helvering* vs. *Chicago Stock Yards Company*, 318 U. S. 693.

The Board did not construe the Act according to the intent and purpose of its enactment but construed it literally and held that the words "any corporation" included all corporations regardless of the country of their incorpora-

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* Article 102-1 of Regulations 94 provides in part as follows: "On the other hand, even though a foreign corporation, whether resident or nonresident, derives income from sources within the United States, if it is composed entirely of nonresident alien individuals who are not engaged in trade or business within the United States and who do not have an office or place of business therein, the tax imposed by Section 102 will not apply, as such individuals would not be subject to the surtax with respect to distributions of the corporation. (See Section 211 (a).)"

tion, or the country of their residence, regardless of the fact that the corporation transacted no business within the United States and that it had no office or place of business therein. The Board also necessarily construed the words "not more than five individuals" to mean any five individuals, whether citizens or residents of the United States and taxable here or nonresident aliens not having an office or place of business within the United States, not transacting business therein and therefore not taxable by the United States.

The findings of fact and the opinion of the Board of Tax Appeals are reported in 47 B. T. A. 280. They appear in the Record at pages 26-34. The opinion of the United States Circuit Court of Appeals for the Fourth Circuit is officially reported in 137 Fed. (2d) 731 and will be found on pages 43-50 of the Record.

The decision of the Board of Tax Appeals was in all respects affirmed by the United States Circuit Court of Appeals for the Fourth Circuit with the following results: (a) Extra-territorial effect is given to the law and the Regulations in that the Commissioner of Internal Revenue is authorized to interfere with and regulate the internal affairs of a corporation, a citizen of and domiciled in the Republic of Switzerland, which transacts no business in the United States and has no office or place of business therein, all of whose stockholders are nonresident alien individuals none of whom transacts any business in the United States or has any office or place of business therein. (b) It levies a surtax against the petitioner which discriminates against it in violation of the terms of the treaty existing between the United States of America and the Republic of Switzerland. Treaty of Commerce and Friendship Proclaimed

November 9, 1855 (United States Statutes at Large vol. 11 p. 587, vol. 18 part 2 p. 748). (c) If petitioner distributed its entire surplus income it would, nevertheless, be liable for the surtax imposed by Section 351 on all of the income it received from sources within the United States. If petitioner did not distribute its income it would still be subject to the surtax imposed by that section, while a domestic corporation or a foreign corporation, having not more than five stockholders who were subject to normal income tax or surtax by the United States, could escape said surtax in its entirety by distributing its surplus earnings to its stockholders.

Holding that the petitioner is liable for the surtax imposed by the statute, whether it does distribute its earnings or does not distribute them, is absurd, unjust, oppressive and discriminative.

In making the decree sought to be reviewed, the Court below disregarded or overlooked the express provisions of Sections 119 (a)(2)(B) and 27(h) of the Revenue Act of 1936, and the provisions of Articles 102-1, 143-1 and 143-9 of the administrative Regulations of the Act of 1936.

Jurisdictional Statement.

The jurisdiction of this Court is invoked under §240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (43 Stat. 938, 28 U. S. C. §347 (a)), §1003(a) of the Revenue Act of 1926 (44 Stat. 110, 26 U. S. C. 1226 (a)), and §1141 of the Internal Revenue Code.

The date of the decree of the United States Circuit Court of Appeals for the Fourth Circuit to be reviewed is August 16, 1943 (R. 31).

Questions Presented.

1. Whether the United States Circuit Court of Appeals for the Fourth Circuit erred in holding that a foreign corporation, which was not engaged in trade or business within the United States and which had no office or place of business therein, all of the stock of which was owned by not more than five nonresident alien individuals, none of whom was engaged in trade or business within the United States and none of whom had an office or place of business within the United States, and which corporation paid the withholding tax on its income from sources within the United States, as provided by Section 144 of the Revenue Act of 1936, was subject to the assessment and payment of the surtax provided for by Section 351 of the Revenue Act of 1936.

2. Whether extraterritorial effect can be given to Section 351 of the Revenue Act of 1936, and an assessment be levied thereunder against a corporation incorporated and domiciled in Switzerland, which corporation transacts no business within the United States, has no office or place of business therein, all of the stockholders of which are nonresident aliens, none of whom transacts business in the United States nor has any office or place of business therein.

3. Whether the United States Circuit Court of Appeals for the Fourth Circuit erred in holding and deciding that the assessment of the surtax provided for by Section 351 of the Revenue Act of 1936 against the petitioner was not in violation of the terms of the treaty existing between the United States and the Republic of Switzerland.

4. Whether the United States Circuit Court of Appeals for the Fourth Circuit erred in disregarding or overlooking

the express provisions of Sections 119 (a)(2)(B) and 27(h) of the Internal Revenue Act of 1936 and Articles 102-1, 143-1 and 143-9 of the administrative Regulations.

5. Whether the provisions of the last sentence of Article 102-1 of the administrative Regulations of the Revenue Act of 1936 apply to *all* foreign corporations composed entirely of nonresident alien individuals who are not engaged in trade or business within the United States and who do not have an office or place of business therein or only to such foreign corporations as are subject to the provisions of Section 102 of the Internal Revenue Act of 1936.

6. Whether the Commissioner of Internal Revenue of the United States has the power and authority to waive enforcement of the provisions of Section 27(h) of the Revenue Act of 1936.

Reasons Relied on for Allowance of the Writ.

(a) A federal question of great importance is involved in this case which has never before been passed upon by any United States Circuit Court of Appeals; which has never before been passed upon, and which should be passed upon by this Court.

Montana Mining Co. vs. *St. Louis Mining Co.*, 204 U. S. 204;
International Railway Co. vs. *Davidson*, 257 U. S. 506.

(b) The Personal Holding Company Surtax Act, Section 351 of the Internal Revenue Act of 1936, and Section

291 of the same Act are involved herein and have never, under similar facts, been passed upon by any court except the court below. The decision in this case is of importance to the administration of the Revenue laws. *United States* vs. *Johnston,* 268 U. S. 220.

(c) The construction given to Section 351 of the Revenue Act of 1936 by the court below is in conflict with other decisions of this Court over a period of one hundred and twenty-five years.

> *United States* vs. *Palmer,* 3 Wheat. 610;
> *American Banana Company* vs. *United Fruit Company,* 213 U. S. 347;
> *United States* vs. *American Trucking Association,* 310 U. S. 534,

and other cases cited in the annexed brief.

(d) The decree sought to be reviewed by the petitioner, in substance and effect, gives to the Internal Revenue Bureau of the United States extraterritorial powers and authorizes that Bureau of the Executive Branch of the Federal Government to regulate the internal affairs of a corporation incorporated and domiciled in the Republic of Switzerland, which corporation transacts no business in the United States and has no office or place of business therein, and is in conflict with prior decisions of this Court.

> *The Apollon,* 9 Wheat. 362;
> *United States* vs. *Bank of New York & Trust Company,* 296 U. S. 463,

and other cases cited in the annexed brief.

(e) The decision of the court below which the petitioner seeks to have reviewed by this Court contravenes the pro-

visions of the treaty existing between the United States of America and the Republic of Switzerland and conflicts with the decisions of this Court in

Cheung Sum Shee vs. *Nagle*, 268 U. S. 336;
Nielson, Adm. vs. *Johnson*, 279 U. S. 47,

and other decisions of this Court referred to in the annexed brief.

(f) The decision of the Court below which petitioner seeks to have reviewed by this Court subjects petitioner to a tax and penalty which discriminates against it, in that other corporations, both domestic and foreign, can escape the surtax involved by distributing their surplus income while the petitioner is subjected to the surtax whether it does or does not distribute its surplus income, and it conflicts with *Greene* vs. *Louisville & Interurban Railroad Co.*, 244 U. S. 499. Constitution of the United States, Article I, Section 8.

(g) In rendering its decision herein the court below disregarded or overlooked the express provisions of the Act involved and the legal effect of the administrative Regulations, which petitioner called to its attention, with respect to both the assessment of the tax and the infliction of the statutory penalty to such an extent that its action should be reviewed by his Court.

WHEREFORE your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Court directed to the United States Circuit Court of Appeals for the Fourth Circuit, commanding said court to certify and send up to this Court, on a date to be designated, a full and complete transcript of the record and of all proceedings in the Circuit Court of Appeals had in this

case, to the end that this case may be reviewed and determined by this Court, according to law; that the decree of the Circuit Court of Appeals be reversed; and that your petitioner be granted such other and further relief as may seem proper and in conformity with law.

And your petitioner will ever pray.

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November 8th, 1943.